SHOULD CALIFORNIA ADOPT AN EARNED INCOME TAX CREDIT?

Kirk J. Stark, Professor of Law, UCLA School of Law*

Introduction

Among the most remarkable stories in the history of the U.S. tax/transfer system is the rise of the federal earned income tax credit (EITC) in the past three decades.[1] What began in 1975 as a relatively modest program designed to supplement the wages of a small number of low-income workers has now become the country's single largest income transfer program, outstripping food stamps, housing subsidies, and the temporary assistance for needy families (TANF) program.[2] Under the EITC program, low-wage workers can receive a federal income tax "refund" larger than what they owe (if anything). For many EITC recipients, these payments provide a crucial supplement to wages that can help to pay for the basic necessities of life.

For the tax year 2003, approximately $39.2 billion in EITC benefits were paid out to more than 22 million claimants – an average benefit of $1,772 per claimant.[3] In addition, unlike many federal programs designed to assist low-income families,[4] the expansion of the EITC has occurred largely as a result of bipartisan support for the program.[5] Liberals and conservatives alike have endorsed the EITC and supported its expansion in the past two decades.[6] As a result of these political developments, academics commenting on a wide range of liberal programs have pointed to the expansion of the EITC as an example of the possibilities of redistributive politics in the 21st century.[7]

As the federal EITC has grown in both size and popularity, state government officials have begun to consider income transfer programs designed to build on its success. Among the programs most commonly considered is the state-level EITC. Not surprisingly, interest in state-level EITCs has ebbed and flowed with the fortunes of state budgets, reaching its peak at the height of the dot.com boom and receding during the economic downturns of 1990-91 and 2001-02.[8]

In recent years, as state revenues have once again begun to rise, proposals for state-based EITCs have resurfaced in state capitals throughout the country in the form of arguments to "make work pay."[9] These efforts have met with some success. As of May 2004, eighteen states had adopted EITCs based on the federal credit.[10] In August 2005, Delaware became the nineteenth state to adopt its own earned income credit.[11] While there are important variations in the design features of these state-based EITCs, most state programs, including the recently enacted Delaware credit, have relied heavily on the basic structure of the federal EITC. Indeed, the most familiar design feature of state-level EITCs is the simple piggyback credit, whereby a state expresses the amount of its EITC as a percentage of the federal credit.

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California's EITC Options

California is one of the states that has not yet adopted its own earned income tax credit. In the past few years, however, the possibility of a California EITC has attracted the attention of state lawmakers and several public policy commentators. Proposed legislation adopting a California EITC has been introduced in the State Assembly and the State Senate. In addition, the California Budget Project has urged the adoption of a California EITC, contending that a state credit would "provide a means to successfully boost the income of millions of low-income California workers patterned after a federal program that has a history of strong bipartisan support."[12] More recently, the Public Policy Institute of California sponsored a comprehensive study of EITC options for California.[13] Stanford economist Thomas MaCurdy, the principal author of the study, has provided a thoughtful and thorough evaluation of the various policy alternatives available to California, should the state legislature decide to pursue such a program. MaCurdy's analysis is especially helpful in its examination of design alternatives that vary quite substantially from the federal model.

In this chapter, I consider the arguments for a California EITC and examine an alternative policy option that has not yet been discussed in the literature—namely, that a state income transfer program may be designed not only to *supplement* the federal EITC, but also to *exploit* and take maximum advantage of the benefits provided by the federal program. While there are, of course, considerable administrative advantages to a simple piggy-back approach, a state that follows the federal system will necessarily forgo the opportunity to use available resources to maximize the federal EITC subsidy to which its residents are entitled. As explained in further detail below, this can be done through the adoption of state policies that increase the earned income of EITC recipients whose income falls within the phase-in range of the federal credit.

The objective of such state policies would be unapologetically selfish from a California point of view. Rather than just supplementing the federal credit, the idea would be to maximize the amount of federal EITC dollars flowing into the state by ensuring that each potential EITC beneficiary earns an amount of income equal to or greater than the "plateau" range within the federal EITC structure. As discussed below, a properly designed state program – i.e., one that takes account of the nuance and detail of federal tax law – can target state resources at those with the lowest levels of household income, while maximizing tax benefits available under federal law. Under this alternative approach, low-income households would be entitled to receive a state payment for some form of "service" rather than as a simple state tax credit.

In examining this alternative to a state EITC, I do not mean to minimize the importance of other worthwhile policy objectives, such as the mitigation of work disincentives arising from the phase-out of federal EITC benefits over the same income range as many other welfare benefits.[14] On that precise question, MaCurdy and others have skillfully identified the pros and cons of the various design alternatives available to policymakers. Rather, my aim in this chapter is to unpack the considerations relating to a previously unexamined question – how can California design its own income transfer

program so as to maximally exploit the benefits already available under the federal EITC?

History and Operation of the Federal EITC

To answer this question, it is necessary to have a basic understanding of the history and operation of the federal earned income tax credit. Originally enacted in 1975, the EITC is a refundable tax credit the precise amount of which depends upon the taxpayer's earned income.[15] In its present form, the EITC wage subsidy has three distinct ranges: a phase-in range over which the amount of the credit increases as the worker's earned income increases, a plateau range over which the amount of the credit is constant regardless of changes in income level, and a phase-out range over which the amount of the credit gradually declines until it reaches zero. Although the EITC is sometimes compared to a "negative income tax," it differs in its incorporation of a phase-in and plateau range.[16]

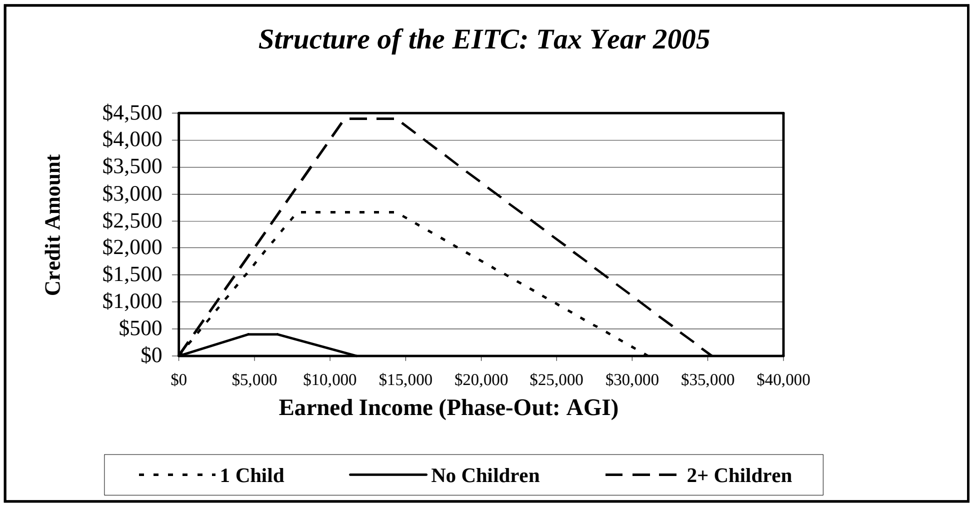
The starting and ending points of these ranges, as well as the rates at which the credit increases or decreases, vary significantly depending on how many children the taxpayer has. In addition, the EITC provisions were recently amended to mitigate the effect of the so-called "marriage penalty" by extending the plateau range for married individuals filing a joint return.[17] For the tax year 2005, the EITC parameters are as shown below:

2005 EARNED INCOME TAX CREDIT PARAMETERS

Type of Return	*Maximum Creditable Earnings*	*Maximum Credit*	*Begin Phase-out*	*Breakeven Point*	*Credit Percentage*	*Phase-out Percentage*
No Children	$5,220	$399	$6,530	$11,750	7.65%	7.65%
1 Child	$7,830	$2,662	$14,370	$31,030	34.00%	15.98%
2 or More Children	$11,000	$4,400	$14,370	$35,263	40.00%	20.06%

Note that the phase-out and breakeven points are $2,000 higher for those filing joint returns.
Source: Rev. Proc. 2004-71, 2004-2 C.B. 1184.

As this table suggests, the amount of credit to which a taxpayer is entitled can vary widely, depending upon the taxpayer's personal circumstances. For example, consider a single parent with two children and total earnings of $11,000. Applying the credit percentage of 40% applicable to taxpayers with two or more qualifying children, this EITC claimant would be entitled to the maximum benefit available, $4,400. Because a taxpayer with this amount of income is unlikely to have positive income tax liability,[18] she would be entitled to a refund of the full $4,400.[19] By contrast, a childless taxpayer earning $7,000 per year would receive just under $400 in benefits. This variability in the amount of benefits can be portrayed graphically with three alternative plateaus, representing the maximum credit available for households with no children, with one child, and with two or more children. As shown below, the credit reaches its peak for claimants with two or more children earning income between the amounts of $11,000 and $14,370.



The generosity of the EITC has increased dramatically in the 30 years since its enactment in 1975. Congress has introduced significant amendments of the credit at various points over the past three decades, including significant expansions in the Reagan, (George H.W.) Bush and Clinton administrations. In 1986, as part of the historic Tax Reform Act, Congress significantly increased both the maximum benefit and the point at which the credit is phased out. In addition, the 1986 Act amended the statute to index the EITC parameters for inflation.[20] This latter change was especially important to ensure the long-term political durability of the program. The benefits of a program not indexed for inflation will, of course, lose value over time, requiring affirmative legislative intervention to keep pace with inflation. An automatic indexing provision turns the tables, requiring affirmative legislative intervention to prevent the increase.

In 1990, during the George H.W. Bush administration, Congress once again expanded EITC coverage by increasing the maximum benefit available under the statute. As part of the 1990 legislation, Congress also chose to differentiate, for the first time, between households with one and two or more children.[21] Finally, the most significant expansion to the EITC occurred during the first year of the Clinton administration as part of the Omnibus Budget Reconciliation Act of 1993. The 1993 legislation further increased the maximum benefit, increased the breakeven point and for the first time made a credit available to childless workers.[22] As Dennis Ventry explains, the cumulative effect of these changes was a substantial increase of the total amount paid out to beneficiaries of the federal EITC: "[u]nder the changes produced by the 1990 and 1993 bills, the cost of the EITC almost tripled, jumping from $7.5 billion in 1990 to $21.1 billion in 1994."[23] Measured over the 1986-1996 period, the growth of the EITC becomes even more apparent, as outlays increased by 1,191 percent.[24]

Emergence of State-Level EITCs

The success and political popularity of the earned income tax credit at the federal level has prompted several state governments to follow suit with state-level EITCs. According to a recent study, eighteen states have earned income tax credits based on the federal credit.[25] And as noted in the introduction, Delaware recently enacted its own

earned income credit based on the federal EITC. In most states, the credit expressly piggybacks on the federal EITC in the sense that the amount of the credit allowable under state law is determined as a percentage of the federal credit. In Maryland, for example, a refundable state EITC is allowable equal to 20% of the amount allowable under the federal EITC. Thus, a taxpayer who is entitled to a $4,000 credit under the federal EITC would be entitled to an $800 credit under the Maryland program. Because the Maryland EITC is refundable, this $800 credit will not only reduce (on a dollar-for-dollar basis) the amount of state income tax owed, but will also entitle the taxpayer to a refund for any excess above the amount of tax owed. Thus, a taxpayer with $500 of positive income tax liability and a state-level EITC of $800 would be entitled to a $300 tax refund.

Not all state-level EITCs are refundable. Iowa, Maine, Oregon, Rhode Island and Virginia all maintain state-level EITCs under which the amount of the credit is limited to the taxpayer's positive tax liability. In these states, the state-level EITC can be conceptualized as expanding the zero-bracket amount of the state's personal income tax. For example, consider a state with a flat-rate personal income tax of 10% that applies to all income above $10,000 and a non-refundable EITC equal to 20% of the federal EITC. Let us assume that taxpayer Dora earns $15,000 of wages and is entitled to a federal EITC of $4,000. In the absence of a state-level EITC, Dora would owe $500 in state income taxes (that is, $15,000 - $10,000, multiplied by the flat rate of 10% = $500). With the 20% piggyback state-level EITC, Dora would be entitled to an $800 credit; because it is non-refundable, however, the credit simply reduces what would otherwise be a positive tax liability of $500 to zero.

As this example suggests, a non-refundable EITC is equivalent to an expanded zero-bracket amount for EITC beneficiaries only. Whereas an expanded zero-bracket amount would simply increase the amount that a taxpayer can earn free of state tax from, say, $10,000 to $15,000, a state-level EITC increases the zero-bracket amount from $10,000 to $10,000 + θ, where θ equals the amount of additional income (above $10,000) required to generate a state-level EITC large enough to reduce the taxpayer's positive tax liability to zero. Note that this is substantially more complicated than a simple expansion of the zero-bracket amount. The exact value of θ depends on the taxpayer's total earned income, the generosity of the federal EITC, and the credit percentage of the state-level EITC.

In the discussion that follows, it will be useful to bear in mind that, despite its failure to jump on the state EITC bandwagon, California already has the highest zero-bracket amount of any state in the country. For example, a family of four with two children will owe no state income tax unless their income exceeds $44,480.[26] This fact is essential in considering the design of a California EITC because for the vast majority of California's low-income households, a non-refundable state EITC would be meaningless due to the fact that they are unlikely to have any positive state income tax liability.[27]

The Federal EITC in California

The issue of whether the State of California should adopt its own earned income tax credit has been the subject of some debate for a number of years. In January 2000, Assembly Member Gil Cedillo introduced AB 106, which would have established a

California EITC equal to 15% of the federal credit.[28] However, as the dot.com bubble began to burst later that spring, the bill lost momentum and was not passed. More recently, in February 2003, Cedillo (now in the state senate) reintroduced the bill, but the legislation has not become law.[29]

To understand the context of the debate over a California EITC, it will be useful to review some basic data relating to the use of the federal EITC within California. For the taxable year 2003, California residents filed approximately 2.5 million federal tax returns claiming benefits under EITC. Total federal EITC expenditures in California came to just under $4.4 billion for the year, or approximately $1,750 per claimant. For the year, the total number of EITC claimants nationwide was 22.1 million, with $39.2 billion in EITC benefits paid. Based on these data, California represents 11.35% of all EITC claimants and 11.18% of total EITC benefits paid.

How are these federal tax benefits distributed among California households? Unfortunately, we do not have good state-level data on the distribution of EITC claims according to income class and filing status. However, a recent study shows the projected distribution of EITC data by income class nationwide.[30] Assuming that these figures are roughly the same in California as in other parts of the country, then the distribution of EITC filers for the state would be approximately as shown in the table below:

ESTIMATED DISTRIBUTION OF FEDERAL EITC CLAIMS IN CALIFORNIA FOR 2003

	Number of Returns	Aggregate Cost	Average Award
Totals (actual)	2,510,046	$4,382,294,000	$1,746
By Phase (estimated)			
Phase-in	760,544	$1,279,467,703	$1,682
Plateau	331,326	$900,710,415	$2,719
Phase-out	1,418,176	$2,202,115,882	$1,553
By Income (estimated)			
$0 - $10,000	913,657	$1,187,087,808	$1,299
$10,000 - $20,000	906,127	$2,363,782,824	$2,609
$20,000 - $30,000	592,371	$789,852,199	$1,333
$30,000 - $40,000	97,891	$41,571,169	$425
By Type of Filer (estimated)			
No Children	397,340	$83,142,337	$209
Head of Household	1,569,984	$3,255,253,435	$2,073
Married	542,722	$1,043,898,228	$1,923

Source: Adapted from 2003 IRS data on California and Carasso & Steuerle (2004)

In addition to these general figures, IRS data offer a glimpse of the geographical distribution of EITC benefits throughout the state of California. In Appendix A, I have

reproduced a table prepared by the Brookings Institution showing the size of EITC claims in each of California's 53 congressional districts. As one would expect in a state with significant income segregation, these data show considerable variation in the spatial distribution of EITC benefits.

For example, the state's 14th district, home to Stanford University and Silicon Valley, claims the smallest amount of federal EITC payments in the state at just under $20 million. By contrast, the 20th district, in the Central Valley, claims almost nine times that amount in federal EITC benefits – nearly $180 million for 2002.[31] Set forth below are the top five congressional districts in the state, ranked by the amount of EITC benefits paid to district residents:

TAX YEAR 2002 EITC DATA BY CONGRESSIONAL DISTRICT: CALIFORNIA (109TH CONGRESS)

District	Representative	Returns	EITC Claimants	% Returns Claiming EITC	EITC Amount
20	Jim Costa	200,082	81,536	40.8%	$ 169,771,682
21	Devin Nunes	240,941	69,195	28.7%	$ 138,896,914
33	Diane E. Watson	283,868	78,655	27.7%	$ 141,449,709
35	Maxine Waters	238,186	77,195	32.4%	$ 155,001,357
43	Joe Baca	245,831	73,455	29.9%	$ 146,022,990
Source: Brookings Institution analysis of IRS data					

EITC payments to residents of these five districts account for approximately 18% of all EITC payments made to Californians in 2002. Interestingly, the combined EITC outlays in these five districts exceed the payments made to EITC claimants in 33 of the 50 states. Indeed, as further evidence of the importance of this federal program to the State of California, EITC payments made to residents of California's 20th congressional district, located in the Central Valley and containing the cities of Fresno and Bakersfield, exceed the EITC payments in 13 states.

In combination, these data give some sense as to the overall cost and distributional effects of a piggy-back credit in California.[32] For example, if California were to adopt a simple piggy-back refundable EITC at a rate of 20% of the federal credit, then the aggregate cost would be in the ballpark of $876.5 million per year, based on 2003 data from the IRS. Four percent of that amount – or $36 million – would be paid to residents of the 20th congressional district. The average award under a 20% credit would be approximately $350 per year. However, as suggested by the figures above, the amount of the award would vary considerably depending on the filer's earned income level and the number of children in the household. For claimants in the phase-in range, the average award would be roughly $336, while for those in the plateau and phase-out ranges, the average award would be $544 and $311, respectively.

Needless to say, the total cost of a state EITC would vary depending upon the credit percentage actually adopted. Moreover, the experience in states that have adopted EITCs suggests that, in the first few years at least, not all intended beneficiaries will claim the state credit. According to one study, first-year participation rates for state

EITCs have varied from a low of 69% (District of Columbia) to a high of 97% (Massachusetts).[33] Finally, as the federal EITC continues to grow, a refundable piggy-back state-level EITC will of course also grow. Using Treasury Department data, it is possible to calculate a projected cost for a California EITC over the years 2006-2010.[34] Assuming that California's share of the EITC remains constant over those years, the aggregate cost to the state of a credit at the 20%, 15% and 10% levels would be in the amounts shown in the table below.[35]

PROJECTED COST OF A CALIFORNIA EARNED INCOME TAX CREDIT, 2004-2010
(in millions)

Year	2004	2005	2006	2007	2008	2009	2010
Projected Cost to Federal Government	$38,024	$38,770	$39,552	$39,651	$40,013	$40,997	$41,699
California Share of Total Federal Cost	$4,251	$4,334	$4,422	$4,433	$4,473	$4,583	$4,662
Cost to California (20% credit)	$850.2	$866.9	$884.4	$886.6	$894.7	$916.7	$932.4
Cost to California (15% credit)	$637.7	$650.2	$663.3	$664.9	$671.0	$687.5	$699.3
Cost to California (10% credit)	$425.1	$433.4	$442.2	$443.3	$447.3	$458.3	$466.2

Policies to Maximize Federal EITC Benefits for Californians

For a state that wishes to adopt some sort of supplement to the federal EITC program, there is considerable attraction to the simple piggy-back approach. Because the statutory and administrative structure for the federal credit is already in place, the state can free ride on the efforts of the federal government. Moreover, the additional burden on the taxpayer is minimal. The only additional filing burden she faces is to fill out one extra line on her state income tax return. In adopting a simple piggy-back approach, however, the state necessarily forgoes the opportunity to use a state wage supplement to increase the flow of federal EITC resources into the state. That is, because state EITC benefits are not counted as "earned income" within the meaning of federal tax law, the supplemental payment has no effect on the amount of federal EITC benefit to which the taxpayer is entitled.

Recall that the earned income tax credit has three distinct phases – a phase-in range, a plateau range, and a phase-out range. For taxpayers whose earned income falls within the phase-in range, additional earned income will result in an increased federal credit. Therefore, state policies aimed at increasing the earned income of these California residents have the potential of increasing the amount of federal dollars flowing into the state.

To illustrate, consider a hypothetical state (Michiana) that has three residents who are potential beneficiaries under the federal EITC. To simplify for purposes of analysis, let us assume that the phase-in range for the federal EITC is $0-$10,000, the plateau range is $10,001-$15,000 and the phase-out range is $15,001-$25,000. We will also assume that the phase-in and phase-out rates are both 50%, such that a one dollar increase in earned income results in a 50-cent increase in EITC benefits in the phase-in range and

a 50-cent decrease in EITC benefits in the phase-out range. The maximum federal EITC benefit in our hypothetical will be $5,000. Finally, we will assume that Michiana is willing to devote $2,000 of its own general fund revenue to a state-level wage subsidy for its three low-income residents. In this hypothetical state, residents A, B and C, with earned income of $5,000, $10,000 and $20,000, respectively, will be entitled to the following EITC benefits:

EFFECT OF FEDERAL EITC IN MICHIANA			
Taxpayer	**Earned Income**	**Federal EITC Subsidy**	**Income after Subsidy**
A	$5,000	$2,500	$7,500
B	$10,000	$5,000	$15,000
C	$20,000	$2,500	$22,500

A simple piggy-back approach, such as that adopted in the vast majority of states discussed in the previous section, would apply some percentage – say 20% – to the federal EITC subsidy and allocate the state-level EITC accordingly. Thus, in our example, a piggy-back approach would give $500 to A, $1,000 to B, and $500 to C. The result is shown below:

EFFECT OF FEDERAL AND STATE EITC (20%) IN MICHIANA				
Taxpayer	**Earned Income**	**Federal EITC Subsidy**	**State EITC Subsidy**	**Income after Subsidy**
A	$5,000	$2,500	$500	$8,000
B	$10,000	$5,000	$1,000	$16,000
C	$20,000	$2,500	$500	$23,000
TOTAL	**$35,000**	**$10,000**	**$2,000**	**$47,000**

An alternative approach designed to maximize the subsidy available under the federal EITC would target the resources in such a manner as to increase the earned income of those persons in the federal EITC's phase-in range – i.e., the "phase-in population" or PIP. I will refer to this option as a "PIP wage supplement" to distinguish it from the option of a state-level EITC. To give the most extreme example, let us assume that the $2,000 that would otherwise have been used to fund the Michiana piggy-back EITC above is devoted instead to funding a PIP Wage Supplement – that is, to increase A's earned income from $5,000 to $7,000. Assuming that the wage supplement would qualify as "earned income" within the meaning of the Internal Revenue Code (a legal issue discussed in more detail below), this approach would increase Michiana residents' income not by $2,000 (the cost of the program to the state), but rather by $3,000. As shown below, the additional $1,000 comes from the increased federal EITC subsidy available by having increased the wages of Worker A.

EFFECT OF FEDERAL EITC AND STATE PIP WAGE SUPPLEMENT IN MICHIANA				
Taxpayer	**Earned Income**	**Federal EITC Subsidy**	**State EITC Subsidy**	**Income after Subsidy**
A	$7,000	$3,500	$0	$10,500
B	$10,000	$5,000	$0	$15,000
C	$20,000	$2,500	$0	$22,500
TOTAL	**$37,000**	**$11,000**	**$0**	**$48,000**

Of course, it goes without saying that this approach is not costless. Most obviously, this approach involves an additional $1,000 expense for the federal government because it increases federal EITC outlays in Michiana from $10,000 to $11,000. Note, however, that this additional expense does not arise from any change in federal policy, but rather from Michiana more fully exploiting the benefits available under existing law. The strategy is similar to a state making changes to its tax system in order to ensure that those taxes are deductible for federal income tax purposes.[36]

A second cost associated with this strategy, as compared to a state-level EITC, is that Michiana can no longer rely on the federal EITC as a piggy-back in crafting the PIP wage supplement. The state EITC option is extremely simple to administer, imposing little or no additional administrative burden on state tax agencies, revenue departments or individual taxpayers. This is not the case for a PIP wage supplement. Most importantly, the state would need to adopt policies to identify individuals with income in the phase-in range of the federal EITC and would need to supplement their wages during the taxable year immediately preceding the year in which the federal EITC would be claimed.

For example, a taxpayer entitled to a federal EITC payment for the tax year 2005 would need to file a federal tax return by April 15, 2006 taking into account her earned income received during the calendar year 2005. In order to supplement the wages of the relevant population, Michiana must know who the potential PIP wage supplement recipients are *before December 31, 2005*.[37] This information presumably would require some sort of preliminary reporting obligation, perhaps at some point during the fourth quarter of the calendar year so that the wage supplement could be paid before the end of the year.

Finally, the distributive implications of the strategy outlined above should not be overlooked. Under the simple piggyback EITC, the distribution of state EITC benefits tracks the distribution of federal EITC benefits exactly.[38] That is, if federal EITC benefits are distributed among the phase-in, plateau and phase-out ranges in the proportions of 35%, 15% and 50%, respectively, then the distribution of state EITC would be exactly the same. In addition to the simplicity of this approach, a piggyback scheme has the advantage of having relatively well-known incentive effects.

By contrast, a PIP wage supplement would be designed to deliver all of the benefits of the state program to those in the phase-in range. This could generate fairness concerns, at least insofar as one objects to transfers that favor extremely low-income

households over other low-income households. Moreover, the incentive effects of a PIP wage supplement could be more severe if comparable benefits are denied to those whose income is just beyond the phase-in range. Concerns like these would need to be addressed in the design of a PIP wage supplement (more on that below). Perhaps more importantly, however, in order for a PIP wage supplement to have the desired effect (i.e., increasing the earned income of persons in the phase-in range of the federal EITC), the state must be able to design income transfers to these households that satisfy the requirements of federal tax law, a question to which I now turn.

Specific Programs Designed to Maximize Federal EITC Benefits to California

In order for payment to generate benefits under the federal EITC, it must qualify as "earned income" within the meaning of federal tax law. Section 32(c)(2) of the Internal Revenue Code defines "earned income" as "wages, salaries, tips, and other employee compensation" as well as "the amount of the taxpayer's net earnings from self-employment."[39] Most significantly for present purposes, section 32(c)(2)(B)(v) of the Code provides that earned income does *not* include amounts received for "service performed in work activities as defined in paragraph (4) or (7) of section 407(d) of the Social Security Act to which the taxpayer is assigned under State program under Part A of Title IV of such Act, but only to the extent such amount is subsidized under such State program."[40]

Adopted by Congress as part of the Taxpayer Relief Act of 1997, this provision excludes from the definition of earned income amounts received on account of "community service" and "work experience" – together sometimes referred to as "workfare payments" – as those terms are defined in the Social Security Act.[41] Congress enacted these provisions as part of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), which replaced the federal program Aid to Families with Dependent Children (AFDC) with Temporary Assistance to Needy Families (TANF). Because of the ambiguity of these terms, and the varied nature of workfare activities under TANF and state welfare laws, it has never been entirely clear which sort of activities will generate earned income and which will not. In an effort to address this ambiguity, the IRS has provided additional guidance regarding the precise scope of section 32(c)(2)(B)(v).

More specifically, IRS Notice 99-3, issued in early January of 1999, articulates a general policy for determining what sorts of activities count as generating "earned income" and which do not.[42] In tax circles, this is sometimes called the "general welfare exception."[43] In general, any transfer of value that constitutes an "accession to wealth" will be regarded as taxable income under the federal tax code and the general standard articulated by the U.S. Supreme Court in its landmark *Glenshaw Glass* decision in 1955.[44] The IRS has a longstanding practice of not applying this expansive concept of income to payments made for the "general welfare." The 1999 Notice spells out the IRS position in some detail.

Notice 99-3 provides that "[i]n cases where the following three conditions are satisfied, TANF payments will be treated as made for the promotion of the general

welfare and therefore will not be includible in an individual's gross income; *will not be earned income for EIC purposes*; and will not be wages for employment tax purposes:

> (1) The only payments received by the individual with respect to the work activity are received directly from the state or local welfare agency (for this purpose, an entity with which a state or local welfare agency contracts to administer the state TANF program on behalf of the state will be treated as the state or local welfare agency);
>
> (2) The determination of the individual's eligibility to receive any payment is based on need and the only payments received by the individual with respect to the work activity are funded entirely under a TANF program (including any payments with respect to qualified state expenditures (as defined in § 409(a)(7)(B)(i)(1) of the Social Security Act)) and the Food Stamp Act of 1977; and
>
> (3) The size of the individual's payment is determined by the applicable welfare law, and the number of hours the individual may engage in the work activity is limited by the size of the individual's payment (as determined by applicable welfare law) divided by the higher of the federal or state minimum wage."

The Notice goes on to explain that the federal income and employment tax treatment of payments failing to satisfy any one of these requirements will be determined under section 4.01 of the Notice, which provides that if "payments by a governmental unit are basically compensation for services rendered, even though some training is provided, then the payments are includible in the individual's gross income and are generally wages for employment tax purposes. … *Similarly, such payments generally are earned income for EIC purposes*."[45]

In other words, so long as a payment made by the state to an individual fails to satisfy one of the three requirements of Section 4.02 of IRS Notice 99-3 and can also be characterized as "basically compensation for services rendered," then those amounts should be considered "earned income" within the meaning of section 32 (the earned income tax credit) of the Internal Revenue Code. This in turn means that receipt of such payments will generate a federal subsidy of up to 40% (for taxpayers with two or more children).

Given that it is a relatively recent pronouncement from the Service, there is almost no authority interpreting Notice 99-3 or applying its general standards to specific facts. In a ruling issued in July 2002, however, the IRS Chief Counsel's office issued a "Chief Counsel Advisory" holding that certain payments made under a Massachusetts property tax abatement program were includible as "earned income" within the meaning of the earned income tax credit.[46] Under the Massachusetts scheme, any city or town could grant property tax abatements to low-income seniors who agreed "to volunteer to provide services to such city or town."[47] The amount of the property tax credit was determined according to the amount of volunteer time devoted to the program and in no event could the credit exceed $500. In addition, the state Department of Revenue advised participating cities and towns to "adopt rules to determine, *inter alia,* any income limitations on eligibility."[48] According to the ruling, several towns have adopted such limits. For example, the town of Hull, Massachusetts limits participation in the program to seniors with income of $15,500 or less ($18,500 if married).[49]

After the Massachusetts state legislature approved this program, a question arose regarding the appropriate federal income tax treatment of the property tax rebate. In the Chief Counsel's 2002 ruling, it was determined that the payments would qualify as earned income under the standards articulated in Notice 99-3. Citing the 1999 Notice, the ruling points out that "[p]ayments do not qualify under the general welfare exception if they are made for services rendered."[50] The ruling also emphasizes that payments under the Massachusetts program are not "received directly from a state or local welfare agency" but instead are credited toward the participant's property tax liability. Finally, the ruling makes much of the fact that the enabling statute authorizes payments only "*in exchange* for the provision of services."[51]

An Opportunity to Increase the Federal EITC

The analysis set forth in Notice 99-3 and the 2002 Chief Counsel's Advisory opinion opens up an opportunity for states such as California to craft income transfer programs specifically designed to supplement the wages of individuals whose income for the year falls within the phase-in range of the federal EITC. Recall that for the tax year 2003, approximately 760,000 California households had income in the phase-in range of the federal EITC. Assuming for the sake of analysis that roughly one-third of those households are families with two or more children, that would mean that there are 250,000 California families who would be entitled to 40 cents in federal EITC benefits for each additional dollar of income that they earn, up to a maximum of $10,750. Thus, for example, a state program that provides $2,000 in additional wages for these families (at a total cost of $500 million per year, less than the proposed 15% piggyback EITC) would generate $800 per family in federal EITC benefits – a total of $200 million of additional federal money for California residents.[52]

What sort of state program would satisfy the standards of Notice 99-3 and the Chief Counsel's opinion? Rather than designing a new program from scratch, it may be possible to structure a PIP wage supplement within existing state welfare programs. In 1997, California adopted the California Work Opportunity and Responsibility to Kids (CalWORKs) program in response to the new federal welfare legislation enacted in 1996 (PRWORA/TANF). Within CalWORKs, counties may adopt so-called "community service" plans in order to comply with these new state and federal welfare-to-work requirements. As presently structured, CalWORKs requires that community service "(1) be performed in the public and private nonprofit sector, and (2) provide participants with job skills that can lead to unsubsidized employment."[53] These provisions give counties wide latitude in structuring community service programs that satisfy requirements of state and federal law. For example, the Community Service Plan published by the Department of Public Social Services of Los Angeles County lists several activities that might qualify as community service, including graffiti removal, administrate or clerical work, maintenance/grounds-keeping, neighborhood beautification, public health assistance, health and social services, and school aides.[54]

Are amounts received by participants in CalWORKs' community service programs "earned income" within the meaning of section 32(c)(2) of the Internal Revenue Code? Following the analysis of Notice 99-3 and the Chief Counsel's 2002

ruling, the answer would appear to be yes, as long as recipients are required as a condition of receipt of the wage supplement to perform services and the amounts paid are not "received directly from the state or local welfare agency."[55] Indeed, according to the California Legislative Analysts Office, one of the principal benefits of the CalWORKs Community Service program is the fact that payments made to beneficiaries will qualify for the earned income tax credit.[56] Other commentators have also emphasized that payments received in a wage-based community service program should qualify for the EITC.[57]

There is some irony in this position. After all, Congress amended the statute in 1997 in order to exclude workfare payments from the definition of "earned income."[58] The legislative history accompanying this provision indicates that "Congress believed it inappropriate to provide the earned income credit for workfare payments."[59] In amending the statute, however, Congress seems to have left the door open for various types of payments to qualify as earned income under the EITC. For example, the statute only excludes from earned income payments for "community service" and "work experience" activities "to which the taxpayer is assigned" under a state program. Where the recipient is not "assigned" to the activity, it would appear that that exclusion does not apply.

Moreover, the 1997 amendment by its terms does not apply to payments received for other activities under section 407(d) of the Social Security Act, including subsidized private or public employment, job skills training, and the provision of child care services to an individual participating in a community service program.[60] In short, there appears to be sufficient flexibility in federal law to structure a state program designed to maximize the earned income of persons in the phase-in range of the EITC. As noted above, unlike a state EITC, such a program could generate additional federal EITC benefits for California residents in an amount up to 40% of the payments.

Conclusion

As the federal EITC has grown in size and popularity over the past three decades, state governments have begun to consider programs designed to build on its success. As noted at the outset of this chapter, state-level EITCs have now been adopted in 19 states across the country. Various commentators have noted the success of these programs in "making work pay." Yet despite the experience of these other jurisdictions, California has yet to adopt its own earned income tax credit.

In this chapter, I have set forth the principal arguments in support of a targeted wage supplement as an alternative to a California EITC. The principal benefit of such a program is that, unlike a state EITC, payments made to beneficiaries could be structured to qualify as "earned income" within the meaning of federal tax law. As a result, for recipients with earned income in the "phase-in" range of the federal EITC, the payments would subsidized by the federal government at a rate of up to 40%. This is in contrast to a federal subsidy of zero percent for state EITC payments. To the extent that California policymakers are concerned about either the cost or generosity of income support programs for the state's poorest residents, this difference in federal subsidy rates is a factor that should be taken into account in evaluating alternative policy options.

Appendix A: EITC Claims by Congressional District

TAX YEAR 2002 EITC DATA BY CONGRESSIONAL DISTRICT: CALIFORNIA (109TH CONGRESS)					
District	**Representative**	**Returns**	**EITC Claimants**	**% Returns Claiming EITC**	**EITC Amount**
01	*Mike Thompson*	288,963	39,155	13.6%	$ 60,886,766
02	Wally Herger	258,219	46,723	18.1%	$ 78,496,413
03	Daniel E. Lungren	306,138	33,556	11.0%	$ 54,611,919
04	John T. Doolittle	308,252	31,264	10.1%	$ 47,737,522
05	[Matsui, Robert T.]	272,150	50,698	18.6%	$ 90,488,985
06	*Lynn C. Woolsey*	293,552	22,035	7.5%	$ 28,767,070
07	*George Miller*	276,766	33,383	12.1%	$ 53,456,548
08	*Nancy Pelosi*	341,862	33,595	9.8%	$ 41,071,601
09	*Barbara Lee*	280,479	36,077	12.9%	$ 55,425,612
10	*Ellen O. Tauscher*	286,179	21,297	7.4%	$ 32,578,970
11	Richard W. Pombo	291,151	28,941	9.9%	$ 48,985,358
12	*Tom Lantos*	309,097	18,747	6.1%	$ 23,854,420
13	*Fortney Pete Stark*	287,037	26,378	9.2%	$ 39,575,504
14	*Anna G. Eshoo*	272,283	14,287	5.2%	$ 19,163,095
15	*Michael M. Honda*	303,731	21,195	7.0%	$ 30,152,115
16	*Zoe Lofgren*	258,833	28,265	10.9%	$ 43,502,261
17	*Sam Farr*	276,094	46,268	16.8%	$ 82,943,682
18	*Dennis A. Cardoza*	244,411	62,455	25.6%	$ 116,646,467
19	George Radanovich	272,724	49,753	18.2%	$ 89,749,055
20	*Jim Costa*	200,082	81,536	40.8%	$ 169,771,682
21	Devin Nunes	240,941	69,195	28.7%	$ 138,896,914
22	William M. Thomas	241,999	43,906	18.1%	$ 81,118,556
23	*Lois Capps*	256,527	40,964	16.0%	$ 70,405,290
24	Elton Gallegly	305,838	31,397	10.3%	$ 50,529,674
25	Howard P. "Buck" McKeon	260,419	45,249	17.4%	$ 83,656,259
26	David Dreier	289,857	33,298	11.5%	$ 53,909,358
27	*Brad Sherman*	236,516	40,310	17.0%	$ 68,522,958
28	*Howard L. Berman*	283,992	69,321	24.4%	$ 126,481,901
29	*Adam B. Schiff*	264,172	46,198	17.5%	$ 75,809,662
30	*Henry A. Waxman*	322,969	25,270	7.8%	$ 28,836,024
31	*Xavier Becerra*	191,062	63,559	33.3%	$ 120,464,218
32	*Hilda L. Solis*	269,287	67,325	25.0%	$ 122,377,996
33	*Diane E. Watson*	283,868	78,655	27.7%	$ 141,449,709
34	*Lucille Roybal-Allard*	210,495	69,215	32.9%	$ 135,787,301
35	*Maxine Waters*	238,186	77,195	32.4%	$ 155,001,357
36	*Jane Harman*	323,574	39,783	12.3%	$ 63,267,702
37	*Juanita Millender-McDonald*	242,128	68,608	28.3%	$ 136,436,310
38	*Grace F. Napolitano*	249,792	61,936	24.8%	$ 115,133,192
39	*Linda T. Sánchez*	219,301	48,501	22.1%	$ 90,743,203
40	Edward R. Royce	254,939	34,433	13.5%	$ 57,156,916
41	Jerry Lewis	262,374	50,073	19.1%	$ 92,296,515
42	Gary G. Miller	279,723	25,040	9.0%	$ 39,137,859
43	*Joe Baca*	245,831	73,455	29.9%	$ 146,022,990
44	Ken Calvert	264,827	43,412	16.4%	$ 77,732,836
45	Mary Bono	257,165	57,259	22.3%	$ 111,209,466
46	Dana Rohrabacher	292,014	28,168	9.6%	$ 41,650,850
47	*Loretta Sanchez*	232,091	57,935	25.0%	$ 107,707,051
48	Christopher Cox	296,998	19,812	6.7%	$ 27,816,627
49	Darrell E. Issa	266,044	42,373	15.9%	$ 76,153,305
50	Randy "Duke" Cunningham	340,287	29,997	8.8%	$ 45,351,738
51	*Bob Filner*	264,891	65,133	24.6%	$ 119,383,039
52	Duncan Hunter	265,592	29,559	11.1%	$ 46,961,963
53	*Susan A. Davis*	320,123	51,203	16.0%	$ 83,644,315
TOTAL		**14,401,825**	**2,353,345**	**16.3%**	**$ 4,138,918,099**

Representatives as of January 3, 2005, as reported by the Clerk of the House Of Representatives
Republicans in roman (21); Democrats in *italic* (32); total 53
Source: Brookings Institution analysis of IRS data

Appendix B: California's 53 Congressional Districts

Endnotes

[1] The provisions of the earned income tax credit are set forth in section 32 of the Internal Revenue Code. *See also* INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY, PUBLICATION 596, EARNED INCOME CREDIT (EIC) (2004).

[2] Participation rates are substantially higher for the EITC than for food stamps or TANF, probably because recipients are already required to file a federal tax return. For a discussion, see Leonard E. Burman and Deborah I. Kobes, *EITC Reaches More Eligible Families Than TANF, Food Stamps*, TAX NOTES 1769 (March 17, 2003).

[3] Internal Revenue Service, *Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2003*, Table 2, Statistics of Income (July 2005).

[4] The political success of the earned income tax credit is in marked contrast to programs such as the minimum wage, which as *The Wall Street Journal* put it, has "lost its status as a tool of social progress in the United States." *See* Rick Wartzman, *How Minimum Wage Lost Its Status As a Tool of Social Progress in the U.S.*, WALL ST. J., page A1 (July 19, 2001).

[5] *See* Dennis J. Ventry, *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit*, *1969-99*, 52 NAT'L TAX J. 983 (2001).

[6] "The earned income tax credit serves as an offset to social security and income taxes and provides works incentives for many low-income families with dependents."—Ronald Reagan.

[7] *See, e.g.,* Gillian Lester, *Unemployment Insurance and Wealth Distribution*, 49 UCLA L. REV. 335, 392 (2001) (citing EITC as "an example of the popular and political success of a direct tax and transfer program targeted at low-income working families" and suggesting EITC expansion in lieu of expanding unemployment insurance).

[8] Between 1997 and 2000, the number of states with their own EITC programs doubled. *See* Deborah Kobes, *State Earned Income Tax Credits*, TAX NOTES, (March 29, 2004).

[9] NICHOLAS W. JENNY, STRONG REVENUE GROWTH CONTINUES IN MOST STATES, STATE REVENUE REPORT, FISCAL STUDIES PROGRAM, THE NELSON A. ROCKEFELLER INSTITUTE OF GOVERNMENT (SEPTEMBER 2005). On the "make work pay" reference, see, e.g., John Freeman, *Michigan Earned Income Tax Credit: A Hand Up, not a Hand Out*, DETROIT METROTIMES (February 16, 2000) (describing Michigan EITC option as "make work pay" strategy).

[10] Joseph Llobrera & Bob Zahradnik, *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2004*, CENTER ON BUDGET AND POLICY PRIORITIES (May 14, 2004).

[11] Ed Hatcher & Amy Beall, *Education, Leadership and Persistence Pay Off in Delaware: New State EITC Will Benefit 28,000 Low-Income Workers*, THE EITC POLICY UPDATE (September 2005).

[12] *Strategies to Reward Work: How Can a State Earned Income Tax Credit Assist California's Working Poor?*, CALIFORNIA BUDGET PROJECT (April 2000). *See also* WESTERN CENTER ON LAW & POVERTY, *Recommendations on CalWORKs: California Working Families Policy Summit 2002* at page 3 (January 18, 2002) (recommending passage of AB 106 (Cedillo), which would have adopted a California EITC).

[13] Thomas MaCurdy, *Evaluating State EITC Options for California*, PUBLIC POLICY INSTITUTE OF CALIFORNIA (2004).

[14] For an overview of this problem, see Daniel N. Shaviro, *Effective Marginal Tax Rates on Low-Income Households*, EMPLOYMENT POLICIES INSTITUTE (1999) (available at http://www.epionline.org/).

[15] 26 U.S.C. §32 (2005) (aka, the "Internal Revenue Code"). As several commentators have noted, the EITC was the brainchild of Senator Russell Long, son of legendary Louisiana populist Huey Long. Long proposed the credit as an alternative to the negative income tax proposal of Nixon's family assistance plan.

[16] Negative income tax proposals typically provide some flat dollar amount which is then gradually reduced as income rises. For a discussion, see Robert A. Moffitt, *The Negative Income Tax and the Evolution of U.S. Welfare Policy*, NBER WORKING PAPER (June 2003).

[17] 26 U.S.C. §32(b)(2)(B) (2005). Note that the marriage penalty in the EITC is still quite significant. For an examination of the issue post-reform, see Saul D. Hoffman, *The EITC Marriage Tax and EITC Reform* (January 2003). Hoffman notes that the major source of marriage penalties in the EITC is the phase-out rate; thus, he proposes reducing the phase-out rate rather than simply extending the plateau range.

[18] A taxpayer filing as a Head of Household for 2005 will be entitled to claim a standard deduction of $7,300. In addition, she will be entitled to a personal exemption of $3,200 for herself, as well as $800 for each of her two children. *See* TAX POLICY CENTER, TAX YEAR 2005 PERSONAL EXEMPTIONS AND

DEDUCTIONS (March 2005) (available at http://www.taxpolicycenter.org). In combination, these provisions serve as an effective "zero bracket" amount.

[19] Under section 3507(b) of the Internal Revenue Code, a taxpayer may, by submitting an "earned income eligibility certificate" (Form W-5) to her employer, elect to receive the earned income tax credit on an advance basis—as a direct supplement to a weekly paycheck, for example—though very few taxpayers make this election. 26 U.S.C. §3507. For a discussion, see Jennifer L. Romich & Thomas Weisner, *How Families View and Use the EITC: Advance Payment versus Lump-Sum Delivery*, 53 NATIONAL TAX JOURNAL 1245, 1247 (2000) (citing evidence that "over 98% of families receive all of the credit as a lump sum along with their income tax refund.").

[20] These provisions are discussed in Dennis J. Ventry, *The Collision of Tax and Welfare Politics,* 53 NAT'L TAX JOURNAL 983, 1002 (2000). As Ventry explains, these changes to the EITC were part of a broader plan of the 1986 Act to eliminate the federal tax burden for low-income households.

[21] A common proposal for reforming the federal EITC is to further differentiate among households by increasing the credit available to families with three or more children. *See*, *e.g.*, Robert Greenstein, *Should EITC Benefits be Enlarged for Families with Three or More Children?*, CENTER ON BUDGET AND POLICY PRIORITIES (July 10, 2000).

[22] Ventry at 1004.

[23] *Id.* at 1004-05.

[24] *Id.* at 1005.

[25] These include Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, New Jersey, New York, Oklahoma, Oregon, Rhode Island, Vermont, Virginia, Wisconsin, the District of Columbia, Colorado and Minnesota. *See* Joseph Llobrera and Bob Zahradnik, *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2004*, CENTER ON BUDGET AND POLICY PRIORITIES (May 14, 2004).

[26] *See* CALIFORNIA BUDGET PROJECT, *Who Pays Taxes in California?* (April 15, 2005).

[27] Of course, the state could always decide to combine a new non-refundable state EITC with a lowered zero-bracket amount. That option is not considered here.

[28] AB 106 (Cedillo, D-Los Angeles) Income Taxes: Earned Income Tax Credit.

[29] SB 224 (Cedillo, D-Los Angeles) Income Taxes: Earned Income Tax Credit.

[30] *See* Adam Carasso and C. Eugene Steuerle, *Projected Distribution of EITC Claims in 2003*, TAX NOTES (July 19, 2004). The table in the text presents California-specific data extrapolated from the Carasso/Steuerle figures. The reader should be aware that the *actual* distribution of California's EITC claimants may vary from the figures in the text.

[31] In its summary of the California Congressional Delegation, the website for the California "Statewide Database" prepared by the Institute of Governmental Studies at the University of California—Berkeley describes the 20th district as follows: "Kings County district with parts of Fresno, and Kern Counties reaching from Fresno to Bakersfield. This district is prime land for agriculture and is home to many vibrant crops and livestock. Consistently Democratic in House and White House elections. This district is 8.1% African American, 6.6% Asian, 63.1% Latino."

[32] In calculating the figures in the text, I have followed the methodology suggested by the Center on Budget & and Policy Priorities. *See* Center on Budget & Policy Priorities, *How Much Would a State Earned Income Tax Credit Cost?*, April 28, 2003.

[33] *Id.* at 2.

[34] These data are taken from BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2006, ANALYTICAL PERSPECTIVES, Table 19-1, *Estimates of Total Income Tax Expenditures* 319 (2005). Note that line 135 from Table 19-1 contains only the cost of the earned income tax credit in terms of "receipts" while Footnote 4 thereof includes the cost in terms of "outlays."

[35] California's share of the total federal cost (that is, the cost to the federal government for EITC claims paid to California residents) for Tax Year 2003 was 11.18%. The figures in the table assume that this 11.18% figure will remain constant over the next five years.

[36] On this strategy, see Kirk J. Stark, *Smart Tax Laws Would Put More Money in California's Pocket*, LOS ANGELES TIMES (December 3, 2003).

[37] This is because the recipients are cash-method taxpayers and thus are required under federal tax law to take income into account as it is received. *See* Treas. Reg. §1.451-1(a).

[38] Of course, this need not be the case. For example, a state may choose to adopt different credit percentages depending upon the recipient's earned income. Thus, a state could decide to offer those with earned income in the phase-in range a state EITC benefit equal to 40% of the federal subsidy, those with earned income in the plateau range a state EITC benefit equal to 20% of the federal subsidy, and those with earned income in the phase-out range a state EITC benefit equal to 10% of the federal subsidy. Such an approach would have different incentive effects (especially at the breakpoints) and would of course also have different budgetary effects.

[39] 26 U.S.C. 32(c)(2).

[40] 26 U.S.C. 32(c)(2)(B)(v).

[41] These provisions were added to Part A of Title IV of the Social Security Act via the Personal Responsibility and Work Opportunity Act of 1996.

[42] Notice 99-3, 1999-1 C.B. 271 (1999).

[43] For a useful introduction, see Robert W. Wood and Richard C. Morris, *The General Welfare Exception to Gross Income*, TAX NOTES (October 10, 2005).

[44] Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955).

[45] IRS Notice 99-3.

[46] IRS CCA 200227003, 2002 WL 1445002 (July 5, 2002).

[47] The Massachusetts program is described in David Bushnell, *Seniors Willing to Work for Towns Can Earn $500 Rebate on Taxes*, Boston Globe (February 18, 2001).

[48] IRS CCA 200227003, 2002 WL 1445002 (July 5, 2002).

[49] *Id.* at note 3.

[50] *Id.*

[51] *Id.*

[52] This assumes that each of these families has earned income $8,750 or less.

[53] California Code, Welfare and Institutions Code, Section 11322.9. In addition, any community service program must "comply with the antidisplacement provisions of Section 11324.6" of the California Code, which is intended to ensure that existing employees are not displaced by this program.

[54] LOS ANGELES COUNTY COMMUNITY SERVICE PLAN, DEPARTMENT OF PUBLIC SOCIAL SERVICES, LOS ANGELES COUNTY (November 2002).

[55] Notice 99-3.

[56] *See CalWORKs Community Service: What Does It Mean for California?*, AN LAO REPORT, LEGISLATIVE ANALYSTS OFFICE 4 (February 4, 1999);

[57] *See*, *e.g.*, Kay Sherwood, *Designing and Administering a Wage-Paying Community Service Program under TANF: Some Considerations and Choices* (April 1999) (noting that "[p]articipants in wage-based CSE are likely to be eligible for the Earned Income Credit, which can increase their income by one-third or more."). *See also* Center on Budget and Policy Priorities, *Workfare Payments And the Earned Income Credit* (2000) (available at http://www.cbpp.org/eic2000/workfare.pdf).

[58] 26 U.S.C. §32(c)(2)(B)(v).

[59] JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 1997, 283 (December 17, 1997).

[60] 42 U.S.C. §407(d)(2), (3), (9), (12).